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**VIA HAND DELIVERY**

Mr. Jim Jarrett
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National Association of Manufacturers (NAM)
1331 Pennsylvania Avenue, NW
Washington D.C. 20004-1790

Re: The Consistency with the WTO obligations of the United States of H.R. 1498, the Hunter-Ryan bill

Dear Mr. Jarrett:

You have, on behalf of the National Association of Manufacturers (NAM), asked us to review H.R. 1498, the "Hunter-Ryan bill," introduced by Congressman Timothy Ryan (D-Ohio) and Congressman Duncan Hunter (R-California), and to comment on its consistency with the obligations of the United States as a Member of the World Trade Organization (the "WTO") under the WTO Agreement on Subsidies and Countervailing Measures (the "SCM Agreement"), which is part of the Marrakesh Agreement establishing the World Trade Organization (the "WTO Treaty").

As a Member of the WTO, the United States remains free to enact any laws it chooses. However, under the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (the "Dispute Settlement Understanding", or "DSU"), which is likewise part of the WTO Treaty, the United States is subject to WTO dispute settlement, and to the consequences of WTO dispute settlement, if any of the laws it enacts are found in such dispute settlement to be inconsistent with its WTO obligations. This includes the obligations of the United States under the SCM Agreement.

Thus, if H.R. 1498 is not consistent with the obligations of the United States under the SCM Agreement, and if H.R. 1498 were enacted by the Congress, and applied by the executive agencies of the United States, then China, as a WTO Member, would have the basis for a successful complaint against the United States in WTO dispute settlement. If

China brought such a complaint in WTO dispute settlement, and if China prevailed, then, under the terms of the Dispute Settlement Understanding, the United States would be faced with the choice of either complying with the adverse WTO ruling or suffering the consequences of the economic sanctions against United States exports to China that could be legally authorized in retaliation under the Dispute Settlement Understanding by the Members of the WTO.

As introduced in the United States House of Representatives, H.R. 1498, the Hunter-Ryan bill, is entitled the "Chinese Currency Act of 2005". As of this date, it remains pending in the 109th Congress. H.R. 1498 , which has been referred to both the Committee on Ways and Means and the Committee on Armed Services, is intended "[t]o clarify that 'exchange-rate manipulation' by the People's Republic of China is actionable under the countervailing duty provisions and the product-specific safeguard provisions of the trade laws of the United States, and for other purposes". "Exchange-rate manipulation" is defined to mean "protracted large-scale intervention by the Government of the People's Republic of China or any other public entity within the People's Republic of China to undervalue its currency in the exchange market that prevents effective balance-of-payment adjustments or that gains an unfair competitive advantage over the United States."

The central thrust of H.R. 1498 is to make "exchange-rate manipulation" by China a countervailable subsidy under U.S. law by essentially defining the Chinese currency regime as having the required elements of such a subsidy. If H.R. 1498 became law, aggrieved U.S. industries would be able to bring countervailing duty cases against imports from China on the grounds that those imports were improperly subsidized by the currency regime maintained by China. If the Department of Commerce (the "DOC") made the requisite finding that a subsidy existed, and if the International Trade Commission (the "ITC") made the requisite finding of "injury" or "threat of injury," DOC would then impose a duty on the Chinese imports in question equal to the amount needed to offset the subsidy that had been calculated. [*]

**Analysis of the WTO Consistency of H.R. 1498**

The seriousness of the problem that the sponsors and the supporters of H.R. 1498 are trying to address is unquestioned. Extensive work has been done by many noted economists and trade experts, and there is broad agreement that the Chinese currency is significantly undervalued, that its continuing "peg" to the U.S. dollar keeps the yuan significantly undervalued, and that the undervaluation of the yuan confers an advantage to Chinese exports to the United States, as well as a disadvantage to U.S. exports to China. The question that we have

[*] H.R. 1498 includes other elements as well, but its central provision is the effort to define China's "exchange-rate manipulation" to be a countervailable subsidy. We offer no view here on those other elements of the bill, apart from noting that some may likewise be questionable under the WTO Treaty. For example, we do not see what the special safeguard mechanism in the Chinese accession agreement with the WTO has to do with countervailable duties to subsidies. At the same time, the special safeguard mechanism does provide an available avenue of relief for injured U.S. industries irrespective of the currency regime.

been asked to address, however, is whether the proposed legislative response set forth in H.R. 1498 — essentially, defining China's currency regime as a countervailable subsidy under U.S. trade law — is consistent with the obligations of the United States under the SCM Agreement. We confine our comments to this question.

Our comments are subject to the following qualifications. In addressing this question at this time, we stress that we have conducted no independent inquiry of the nature, structure, or operations of the Chinese currency regime. Nor have we examined any specific measure or measures of the Chinese government. Rather, we offer our comments based solely on our understanding of the operations of the Chinese currency regime without any such inquiry or examination. Furthermore, we emphasize as well that, in WTO dispute settlement, the outcome is determined to a great extent by the facts of the measure at issue, and that therefore the actual factual operations of the Chinese currency regime would be central and crucial to a determination by the WTO as to whether the application of countervailing duties would be justified in any given case. Significant, too, would be the ability of the United States to demonstrate those operations in that case.

With these qualifications in mind, our understanding is that China pegs its currency, the yuan (renmimbi), to the U.S. dollar, and that, under this system, China's central bank issues a reference dollar/yuan exchange rate along with a limited band in which the reference rate is allowed to fluctuate. We understand further that, to maintain a fixed exchange rate with the United States, the Chinese central bank buys and sells as much currency as is needed to keep the yuan-dollar exchange rate constant. We understand as well that, to accomplish these purposes, the Chinese government has imposed strict controls on foreign-currency exchange, and, specifically, on the amounts of U.S. dollars that are permitted in the Chinese economy. In particular, we understand that U.S. dollars are largely prohibited in China except in the three cases of foreign-exchange export revenues, the repatriation of profits earned by Chinese firms abroad, and inflows of foreign direct investment; and that, in those three cases, U.S. dollars must be submitted by the recipient to the Chinese government in exchange for yuan at the pegged exchange rate.

All this said, if H.R. 1498 were enacted into law, and if China challenged that law, an application of that law, or both, in WTO dispute settlement, the initial inquiry of a WTO panel would be whether that law addressed a "subsidy" maintained by the Chinese government within the meaning of the SCM Agreement. One of the most important innovations of the SCM Agreement in international trade law is that it defines a "subsidy" that can, under the circumstances set out in that Agreement, be subject to relief in the form of countervailing duties, and the first question asked by a WTO panel will, therefore, be whether a "subsidy" exists in China justifying such a countervailing measure by the United States.

Article 1.1 of the SCM Agreement provides that:

"For the purposes of this Agreement, a ***subsidy*** shall be deemed to exist

if:

(a) (1) there is a ***financial contribution*** by a government or any public body within the territory of a Member (hereinafter referred to as "government"), i.e., where:

(i) Government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees):

(ii) Government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);

(iii) A government provides goods or services other than general infrastructure, or purchases goods;

(iv) A government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the types of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

or

(a) (2) there is any form of income or price support in the sense of Article XVI of the GATT 1994;

***and***

(b) a ***benefit*** is thereby conferred.

(emphasis added)

Thus, for a "subsidy" to exist within the meaning of the SCM Agreement, there must be *both* a "financial contribution" *and* a "benefit". If there is a "financial contribution" without a "benefit," or if there is a "benefit" without a "financial contribution," then there is no "subsidy," and the measure in question does not fall within the scope of the SCM Agreement. The WTO Appellate Body has emphasized that the requirement of a "financial contribution" and the requirement of a "benefit" as the legal criteria for a "subsidy" under the SCM Agreement are

two separate elements. They are "two discrete elements". *Canada-Aircraft* (WT/DS70/AB/R), para. 156. They are "two distinct elements." *United States-Softwood Lumber IV* (WT/DS257/AB/R), para. 51. These two discrete, distinct elements must not be conflated in determining whether there is a "subsidy".

H.R. 1498 would change United States law to include "exchange-rate manipulation" within the statutory definition of those actions that confer a "benefit". The notion underlying this proposed change in the definition of a "benefit" in U.S. law is that "exchange-rate manipulation" by China provides an advantage to Chinese products in the marketplace because it results in an undervaluation of the Chinese yuan, this undervaluation makes Chinese exports to the United States cheaper and U.S. imports into China more expensive, and this price distortion adds to China's surplus in the growing imbalance of trade between the two countries. As we have said, our understanding from various economic reports is that this is indeed what is happening in the two-way trade between the United States and China.

In our view, this particular provision of H.R. 1498 is probably consistent with the meaning of a "benefit" under the SCM Agreement. Generally, a "benefit" under Article 1.1(b) of the SCM Agreement has been found in WTO dispute settlement to mean an advantage conferred on a recipient in the marketplace. Assuming that there are facts sufficient to satisfy a WTO panel that such an advantage exists for Chinese producers as a result of the Chinese currency regime, we think it likely that a WTO panel would find that "exchange-rate manipulation" does confer a benefit on Chinese goods in trade with the United States.

But while we think it likely that there is a "benefit, " we foresee difficulty for the United States in demonstrating that there is also a "financial contribution," and, thus, we foresee difficulty in showing that "exchange-rate manipulation" by China provides a "subsidy" within the meaning of the SCM Agreement. If there is no "subsidy," then, under the terms of the SCM Agreement, the United States would be acting inconsistently with its WTO obligations if it applied countervailing duties in response to "exchange-rate manipulation" by China as envisaged in H.R. 1498.

H.R. 1498 would also change United States law to specify that China's "exchange-rate manipulation" constitutes a "financial contribution." But "exchange-rate manipulation" will be found by a WTO panel to provide a "financial contribution" only if it can be shown that the actual operation of the Chinese currency regime fall within the definition of a "financial contribution" in Article 1.1(a) of the SCM Agreement. Thus, those actions must fall within the scope either of one or the other of the two sub-definitions of "financial contribution" in Article 1.1(a) and Article 1.1(a)(2) of that Agreement.

Although there is no definitive WTO case law that says as much, we are of the view that Article 1.1 provides an exclusive, exhaustive list of those measures that satisfy the definition of

a "financial contribution" in the SCM Agreement. We refer to the term "i.e." in the prefatory phrase to Article 1.1 (a)(1), which, as we read it, denotes that what follows is an exclusive list.

Governments make many different kinds of financial contributions to their citizens and to their industries, but not all of them by any means are "financial contributions" for the purposes of the SCM Agreement. As the WTO Appellate Body has stated, "[N]ot all government measures capable of conferring benefits would necessarily fall within Article 1.1(a). If that were the case, there would be no need for Article 1.1(a), because all government measures conferring benefits, *per se,* would be subsidies. In this regard, we find informative the discussion of the negotiating history of the *SCM Agreement* contained in the panel report in *US-Export Subsidies*, which was not appealed. That panel, at paragraph 8.65 of that panel report, said that the:

> …negotiating history demonstrates…that the requirement of a financial contribution from the outset was intended by its proponents precisely to ensure that not all government measures that conferred benefits could be deemed to be subsidies. This point was extensively discussed during the negotiations, with many participants consistently maintaining that only government actions constituting financial contributions should be subject to the multilateral rules on subsidies and countervailing measures. (footnote omitted)"

The Appellate Body has further stated that "the object and purpose of the *SCM Agreement*… reflects a delicate balance between the Members [of the WTO] that sought to impose more disciplines on the use of subsidies and those that sought to impose more disciplines on the application of countervailing measures." *United States-DRAMS* (WT/DS296/AB/R), para. 115. With this in mind, the Appellate Body has, as to one aspect of the definition of a "financial contribution," that in Article 1.1(a)(iv), said that "the interpretation of paragraph (iv) cannot be so broad as to allow Members to apply countervailing measures to products whenever a government is merely exhausting its general regulatory powers." *Id.* We think it likely the Appellate Body would apply this same reasoning to all other aspects of the definition of a "financial contribution" as well.

Notably, in that same case, relating to paragraph (iv), the Appellate Body described a situation where *"nothing of value has been transferred* from the grantor to the recipient" and therefore "there is no financial contribution and, consequently, there would be no right to apply countervailing measures." *Id.* at para. 125. (emphasis added) Elsewhere, the Appellate Body has stated that "a 'subsidy' involves a *transfer of economic resources* from the grantor to the recipient for less than full consideration." *Canada-Dairy* (WT/DS103/AB/R), para. 87.

(emphasis added) The Appellate Body has stated as well that, "The concept of subsidy defined in Article 1 of the SCM Agreement captures situations in which *something of economic value is transferred* by a government to the advantage of a recipient." *US-Softwood Lumber IV* (WT/DS257/AB/R), para. 51. (emphasis added) Furthermore, the Appellate Body has added, "An evaluation of the existence of a financial contribution involves consideration of the *nature* of the transaction through which something of economic value in transferred by a government." *Id.* at para. 52. (emphasis added) US-*Softwood Lumber IV* (WT/DS257/AB/R), para. 52, footnote 35.

Given all this, we are not of the view that a WTO panel is likely to find that the currency exchange practices of the Chinese government, as we understand them, in pegging the value of the yuan to the value of the U.S. dollar, involve a transaction of the nature, or the kind of transfer of economic resources, that constitutes a "financial contribution" under any of the subparagraphs of Article 1.1(a)(1). As we understand it, the currency regime in China does not involve a direct transfer of government funds (by grants, loans, or equity infusion), or a potential direct transfer, or the foregoing of government revenue "that is otherwise due." Nor does it involve the provision of "goods and services other than general infrastructure" or payments out of a funding mechanism. Nor does it, in our understanding, involve any cost to the Chinese government in economic resources, in something of value, which seems to us to be necessarily incidental as a consequence of a "transfer" to a recipient that is necessary to a "subsidy" (unless one counts the possible long-term macroeconomic consequences for China of an undervaluation of the yuan, which would be exceedingly difficult to prove in WTO dispute settlement.)

Here we reiterate: the two separate elements of a "financial contribution" and a "benefit" in the definition of a "subsidy" must not be conflated. They must both be proven, and they must both be proven *separately*. Proof of an advantage to the recipient in the marketplace is proof of a "benefit"; it is *not* proof of a "financial contribution." Proving the existence of a "financial contribution" is an independent requirement that focuses on the "nature " of the government action, and on the consequences of the action *for the government*. And, in our view, it will be difficult to prove the existence of a "financial contribution" if it cannot be shown persuasively that there is a real cost to the government from a transfer of economic resources — entirely independent from whether there is a "benefit" to the recipient from the governmental action.

There are some statements in GATT/WTO case law (such as those relating to the maintenance of multiple exchange rates) that can be construed to support the view that actions of this "nature" can, under some circumstances, fall under the scope of Article 1.1(a)(i). And it is possible that, upon examination in WTO dispute settlement, the structure and operation of the Chinese currency regime could be revealed as such that does fall under the scope of Article 1.1(a)(i). But, as we understand the Chinese currency regime, we think it more likely that a WTO panel and the WTO Appellate Body would conclude that it does not.

Likewise, we do not see "exchange-rate manipulation" as satisfying the definition of a "financial contribution" in Article 1.1(a)(2) as including "any form of income or price support in the sense of Article XVI of GATT 1994." Although here, too, there is no definitive WTO case law, we think it likely that a WTO panel and the WTO Appellate Body would conclude that "income or price support" as used here is meant to mean conventional income and price support programs for specific products intended to maintain incomes or prices at levels higher than they otherwise would be, and not a general policy of "exchange-rate manipulation", which, as we will take up later, is addressed specifically elsewhere in the GATT.

But even assuming that there is a "financial contribution," and that there is a "benefit," and that therefore there is a "subsidy" resulting from Chinese "exchange-rate manipulation" that falls within the definition of a "subsidy" in the SCM Agreement, we foresee further difficulties for the United States in demonstrating that H.R. 1498 would be consistent with the WTO obligations of the United States in authorizing the imposition of countervailing duties in response to such a "subsidy".

As the WTO Appellate Body has stated, "The universe of subsidies is vast. Not all subsidies are inconsistent with the SCM Agreement." *Canada-Aircraft (Article 21.5-Brazil)* (WT/SD70/AB/RW), para. 47. A measure of a WTO Member may fall within the definition of a "subsidy" in the SCM Agreement but may nevertheless *not* be inconsistent with the obligations of that Member under that Agreement. A vast array of subsidies are perfectly permissible under the SCM Agreement, and are therefore not subject to countervailing duties or to other countervailing measures under that Agreement.

Certain kinds of subsidies are inconsistent *per se* with the SCM Agreement. As defined in Article 3.1 of the SCM Agreement, these "prohibited subsidies" are subsidies that are "contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance," or are "contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." As for prohibited subsidies that are contingent "in fact" on export performance, footnote 4 of the SCM Agreement states, "This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation of export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision."

As we understand it, there is no serious question of whether the Chinese currency regime is contingent on export substitution. Furthermore, as we understand it, the question is not whether the Chinese currency regime is contingent *in law* on export performance. Rather, as we understand it, the question is whether the Chinese regime is contingent *in fact* on export performance. This is the allegation, for example, that has been made by the China Currency Coalition in its recent petition for relief under Section 301(a) of the Trade Act of 1974, as amended. Thus, we confine our comments on prohibited subsidies to this question.

The Appellate Body has said that the "the key word" in Article 3.1(a) is "contingent". *Canada-Aircraft"* (WT/DS70/AB/C), para. 166. It has endorsed the view that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'." *Id.* And it has upheld a panel finding that a subsidy is *de facto* contingent "if there is a relationship of conditionality or dependence between 'the grant of the subsidy' and the 'anticipated exportation or export earnings'." *Id.* at para. 162.

In examining the relationship between the subsidy and the exports, the Appellate Body, relying on footnote 4, has said that the standard for determining *de facto* contingency "requires proof of three different substantive elements: first, the *granting* of a subsidy; second, "is…*tied to"*; and, third, "actual or anticipated exportation or export earnings." *Id.* at para 169.

If we assume, for the sake of argument, that the Chinese currency regime does satisfy the first of these three elements through the "granting of a subsidy" by the Chinese government; and if we assume, as seems reasonable, that the third of these elements is satisfied in that Chinese producers do have "actual or anticipated exportation or export earnings," then the remaining question, and the key question, is whether the second of the three elements is satisfied: whether the grant of the subsidy is *"tied to"* the exports.

As we understand the Chinese currency regime, it is not. As the Appellate Body has observed, *de facto* contingency "must be inferred from the total configuration of the facts surrounding the grant of the subsidy, none of which on its own is likely to be decisive in any given case." *Id.* at para. 167. And, on the facts as we understand them, the exchange of undervalued yuan for U.S. dollars by the Chinese government is not "tied to," conditioned on, or dependent on exports. Such currency exchange is certainly available to exporters, who, as we have already concluded, certainly "benefit" from it. But, while the availability of such exchange is limited, it is, as we understand it, equally available to those who receive U.S. dollars from the repatriation of profits earned abroad, and to those who receive U.S. dollars from the inflows of foreign direct investment. The subsidy—if it is a subsidy — is not "tied to" exports; it is "tied to" having U.S. dollars that can and must be exchanged with the Chinese government for yuan. It is available to those who do *not* export if they have U.S. dollars as a result of foreign profits or foreign investment.

Some may argue that the "total configuration of the facts" says otherwise, and, again, our understanding of the Chinese currency regime may be incorrect. But nothing in the "total configuration of the facts" can compensate for a failure to satisfy one of the three essential elements of *de facto* contingency.

Of course, assuming there is a subsidy, as exports increase, so too does the value of the subsidy. But this is an increase in the "benefit." It is not determinative proof of *de facto* contingency. It is true that the Appellate Body itself has suggested that there can be a legal

significance when the benefit under the measure increases along with the volume of exports. *Canada-Autos*, (WT/DS139/AB/R), para. 108. But this is only one in the total configuration of facts to be considered in evaluating a measure. It need not be determinative. Whether it is a significant fact in any given case will depend on the other facts of the measure.

It is also true that the Appellate Body has found that a contingency can exist even though the benefits of the subsidy are not limited to exporters. In *United States-Upland Cotton* (WT/DS267/AB/R), para. 583, the Appellate Body upheld a panel ruling that the "Step 2" program of the United States was contingent on export performance even though Step 2 payments were available not only to exporters, but also to domestic users of cotton.

But that decision in that dispute turned on the fact that, in the measure at issue there, "the statute and regulations themselves clearly distinguish between exporters and domestic users." *United States-Upland Cotton*, para. 576. Furthermore, the statue and regulations in that dispute established "different conditions" that eligible exporters and eligible domestic users had to meet in order to receive Step 2 payments. *Id.* at para. 577.

As we understand it, the Chinese currency regime does not clearly distinguish between exporters and others, and it does not establish different conditions that exporters and others must meet in order to exchange U.S. dollars for yuan from the Chinese government. As we understand it, the terms of the exchange are the same whether there are exports or not. If this is so, then, in this way, the situation in *United States-Upland Cotton* may be distinguished.

Likewise, while, as we understand it, the amount of the benefit increases with the volume of U.S. dollar receipts from exports, it is also the case that the amount of the benefit increases, for others who receive it, with the volume of U.S. dollar receipts repatriated on foreign profits, and with the volume of U.S. dollar receipts from foreign direct investment. Exports are not, as we understand it, singled out for special treatment under the Chinese currency regime. If this is so, then, in this way, the situation in *Canada-Autos* may also be distinguished.

Thus, in sum, we do not think it likely, assuming there is a subsidy, that a WTO panel would find that it is a prohibited subsidy that is contingent in fact on export performance. Here though, once more, we qualify our conclusion by underscoring that, like one other conclusions in these comments, it is based on our understanding of the Chinese currency regime, and thus is subject to it.

If a "subsidy" is not a prohibited subsidy, then, under the SCM Agreement, to be actionable and subject to countervailing duties, it must be "specific". Under Article 2 of the SCM Agreement, to be "specific,'' access to the subsidy must be limited to certain enterprises, certain industries, or certain geographical regions. If not, then the subsidy is not actionable, and it is not subject to countervailing duties.

In essence, the SCM Agreement provides that governments cannot target subsidies to specific enterprises, or specific industries, or specific geographic regions, so as to provide them with an advantage over their competitors in international trade. To our knowledge, there is no element of such "specificity" in the Chinese currency regime. Pegging the yuan to the U.S. dollar affects the entire Chinese economy. And even if we confine our view to exporters, pegging the yuan to the U.S. dollar affects every Chinese enterprise that exports to the United States, every U.S. enterprise exporting or seeking to export to China, and, indeed, all U.S. and Chinese companies that compete with each other in international trade. As we understand it, the Chinese currency regime policy may be many things, but one thing it is not is "specific."

In sum, the Chinese government maintains an exchange rate regime that results in its currency being undervalued. That undervalued currency affects the terms of competition in trade between the United States and China, and it affects trade more generally by disadvantaging U.S. exports around the world vis-à-vis Chinese exports. This regime represents an important challenge to the international trade and monetary systems. But, as we understand it, the Chinese exchange rate regime probably does not fall within the meaning of "subsidy" as defined by the WTO Agreement on Subsidies and Countervailing Measures, and even if it does, it is neither a prohibited nor an actionable subsidy under that Agreement.

Additional support for our conclusion comes from the juxtaposition of Articles XV and XVI of GATT 1994. To the extent that the WTO offers a remedy for currency arrangements that distort the terms of trade, it seems to us that it is more likely to be found in Article XV of the GATT 1994, which is part of the WTO Treaty, and is therefore likewise enforceable in WTO dispute settlement. Article XV (4) of the GATT 1994 states that "Contracting Parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund." Although the main thrust of Article XV is to ensure appropriate consultation and coordination between the GATT and the International Monetary Fund, recognizing the close interrelationship of trade and exchange rate issues, Article XV (4) plainly envisions cases in which a GATT Contracting Party, or, now, a WTO Member, could, through its exchange rate actions, "frustrate" the intent of the trade Agreement. (See Panel Report, *Special Import Taxes Instituted by Greece*, adopted November 3, 1952, BISD DS/48).

In a major joint study recently by the Center for Strategic and International Studies and the Institute of International Economics, a prominent team of economists, led by Fred Bergsten and Nick Lardy, wrote:

> China's large external imbalance poses a major risk to the global economy….. As the world's second largest surplus country, China must allow its currency to appreciate against the dollar…..It has a huge and rising external surplus, reflecting the substantial

> undervaluation of its currency. In addition, the dollar has already depreciated substantially against the world's major floating currencies, but needs to depreciate an additional 25-30 percent in order to reduce global imbalances to a sustainable level….At least in some Asian countries, policies to avoid appreciation have been adopted because of a concern about a loss of national competitive position to China in third country markets. Thus, if China were to allow its currency to appreciate significantly, it likely would lead to the desired general appreciation of the Asian currencies vis-à-vis the dollar. "*China in the World Economy,"* pp. 95-95 (2006)

Because Article XV is solicitous of the relationship between trade and currency arrangements, a WTO panel would undoubtedly give considerable deference to the views of the IMF. The IMF has been tempered in its descriptions of the implications of Chinese exchange rate policy. For example, in its most recent Article IV consultations with China, which concluded almost a year ago (September 12, 2005), the IMF Executive Board noted:

> Directors noted the change in the exchange rate regime-- an important move toward greater exchange rate flexibility-- and encouraged the authorities to utilize the flexibility afforded by the new arrangement. Noting the difficulty in assessing with reasonable degree of confidence the "equilibrium" exchange rate for China, they agreed that a more flexible exchange rate, not simply a revaluation, is key to providing for monetary policy independence and enhancing the economy's resilience to external shocks. Going forward, many Directors supported a gradual, cautious approach to further increasing exchange rate flexibility…However, a number of other Directors recommended that the authorities allow the exchange rate to move more quickly toward a level that better reflects underlying market forces.
>
> Directors emphasized that greater exchange rate flexibility is in China's best interest. *They also considered that, as correcting global imbalances is a responsibility of all major countries, China's move toward greater exchange rate flexibility would*

> *contribute directly to that process, as well as indirectly by facilitating greater exchange rate adjustments in other Asian countries. (italics added)*
>
> 2005 Report of the IMF Executive Board on Article IV Consultations with China.

We would not venture to predict the outcome of a WTO case based on the contention that China's currency regime violates Article XV (4) of GATT 1994 by "frustrating" the intent of the WTO Treaty. There is no precedent for a case being brought against the overall operation of a country's currency regime. However, in our view, whatever the impediments to success in a WTO challenge brought under Article XV (4), the chances of success in such a case would be significantly better than the chances that H.R. 1498, if enacted, would be able to withstand a challenge by China against the United States in WTO dispute settlement. If there is an appropriate provision for challenging "exchange-rate manipulation" in the WTO, then, to us, clearly Article XV (4) is it.

We do not mean to suggest in these comments that aspects of the currency exchange policies of WTO Members could never be actionable or prohibited "subsidies" within the meaning of the SCM Agreement. (Indeed, there are exchange-rate aspects to both Item (b) and Item (j) of the "Illustrative List of Export Subsidies" which is Annex I to the SCM Agreement.) Instead, in conclusion, we suggest that the nature of the macroeconomic monetary policies of the Members of the WTO is such that the vast majority of WTO Members would be surprised if told that, in agreeing to the SCM Agreement as part of the WTO Treaty, they had agreed to subject fundamental national decisions about their overall monetary policies, not to their duly chosen national leaders, and not to the International Monetary Fund, but to the jurists of the WTO in subsidies disputes in WTO dispute settlement. The vast majority of the Members of the WTO are undoubtedly of the view that the appropriate remedy for exchange actions that frustrate the intent of the WTO Treaty is found, rather, in Article XV (4) of the GATT.

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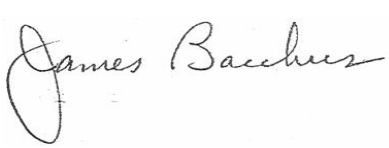
By: 

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